HARKINS CUNNINGHAM LLP

Attorneys at Law

David A. Hirsh
202.973.7606
dhirsh@harkinscunningham.com

1700 K Street, N.W.
Suite 400
Washington, D.C. 20006-3804

Telephone 202.973.7600
Facsimile 202.973.7610

218723

February 26, 2007

BY E-FILING

The Honorable Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
1925 K Street, N.W.
Washington, DC 20423-0001

Re: ***Simplified Standards for Rail Rate Cases*** **(STB Ex Parte No. 646 (Sub-No. 1))**

Dear Secretary Williams:

Canadian National Railway Company and its U.S. rail carrier subsidiaries (collectively, "CN") hereby submit their Supplemental Comments for inclusion on the record of this proceeding, in accordance with the Board's decision served on January 22, 2007.

Very truly yours,

David A. Hirsh

Enclosure

cc: All Parties of Record

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

SUPPLEMENTAL COMMENTS OF CANADIAN NATIONAL RAILWAY COMPANY

Sean Finn
Senior Vice-President Public Affairs,
Chief Legal Officer and Corporate Secretary
CANADIAN NATIONAL RAILWAY COMPANY
P.O. Box 8100
Montréal, PQ H3B 2M9
(514) 399-6500

Paul A. Cunningham
David A. Hirsh
HARKINS CUNNINGHAM LLP
1700 K Street, N.W., Suite 400
Washington, DC 20006-3804
(202) 973-7600

Theodore K. Kalick
CANADIAN NATIONAL RAILWAY COMPANY
Suite 500, North Building
601 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 347-7840

Counsel for Canadian National Railway Company

February 26, 2007

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

SUPPLEMENTAL COMMENTS OF CANADIAN NATIONAL RAILWAY COMPANY

Pursuant to the Board's pre-hearing decision served January 22, 2007, Canadian National Railway Company (and its U.S. rail carrier subsidiaries) (collectively, "CN") hereby submits its supplemental comments in this proceeding.[1] CN's comments address the practicality and importance to the public interest of the Board considering movement-specific adjustments to URCS system-average costs under its proposed simplified rate methodologies, which was the subject of CN's statement at the Board's January 31, 2007 hearing as well as the subject of a number of questions from the Board.

[1] CN also joins in the supplemental comments filed on behalf of the railroad industry by the Association of American Railroads ("AAR").

THE BOARD'S PROPOSED SIMPLIFIED RATE METHODOLOGIES CAN READILY ACCOMMODATE CRITICAL ADJUSTMENTS TO URCS SYSTEM AVERAGE COSTS

A. There is general agreement that some adjustments or additions to URCS system average costs are necessary and should be permitted.

CN explained in its opening and rebuttal comments, and in its statement at the Board's hearing, that it is both critical and practical for the Board to permit certain movement-specific adjustments to URCS system average costs for each of its proposed simplified rate reasonableness methodologies.[2] Many other parties, including shipper interests, expressed similar support.[3] All parties that have addressed the issue appear to recognize that unadjusted URCS costs by themselves can present a highly misleading estimate of the variable costs of movements. In some instances, there are variable costs that URCS system averages fail to account for at all. In other instances, exclusive reliance on URCS system averages would result in a gross mis-estimation of variable costs.

---

[2] *See* CN Opening Comments at 4-6; CN Rebuttal Comments at 3-7.

[3] See, e.g., UP Opening Comments at 34-43 (allow URCS adjustments in simplified SAC cases for hazmat for all purposes and for high/wide movements and railroad payments to third parties and shippers for jurisdictional threshold calculations); UP Rebuttal Comments at 19-27 (same); CSX/NS Opening Comments at 16-22 (allow URCS adjustments in simplified SAC and Three Benchmark cases at the prescription phase); CSX/NS Rebuttal Comments at 38-44 (same); BNSF Opening Comments at 11-12 (allow URCS adjustments in simplified SAC and Three Benchmark cases for payments to third party service providers and also allow other necessary adjustments prior to rate prescription); BNSF Rebuttal Comments at 8 (same); CP Opening Comments at 12-15, 18 (allow movement specific adjustments to URCS in simplified SAC and Three Benchmark cases); AAR Opening Comments at 14 (retain sufficient flexibility to allow URCS adjustments in simplified SAC and Three Benchmark cases); AAR Reply Comments at 16-18 (allow adjustments to include costs that are actually incurred but are not captured or are grossly understated by URCS); AAR Rebuttal Comments at 11-12 (same); Arkansas Electric Cooperative Corp. Opening Comments at

In its prior comments and oral statement, CN outlined what is perhaps the most glaring and important example of such costs, the wide range of additional costs that may apply to hazmat movements, particularly toxic inhalation hazards ("TIH") (also known as material poisonous by inhalation or "PIH"), environmentally sensitive chemicals, and time-sensitive materials. *See* CN Opening Comments at 5; CN Rebuttal Comments at 3-7. *See also* AAR Circular No. OT-55-H (Aug. 25, 2005), Appendix A. These costs are real and most are readily measurable, but they are not reflected in system average URCS.

In addition, these costs are increasing. Carriers will soon be incurring significant added costs associated with new security and safety requirements imposed by other federal agencies. These include security action items announced on November 21, 2006, by the Department of Homeland Security (DHS) and the Department of Transportation (DOT) for the movement of the most hazardous of the hazmats (TIHs such as chlorine and anhydrous ammonia) through "high-threat urban areas." Among other things, the items direct railroads to reduce the risk of TIH transport by 25% in the first year, principally by reducing the dwell times of TIH cars in high threat urban areas.

On December 21, 2006, DHS's Transportation Security Administration (TSA) also proposed regulations that would require rail carriers to provide – within one hour of the agency's request – shipping and location information for cars on their networks containing these hazmats and other commodities such as radioactive waste and certain

---

9-10 (don't mandate use of unadjusted URCS for simplified SAC until URCS modifications can be undertaken in an URCS proceeding); Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King") Reply Comments at 7, 14 (in Three Benchmark cases allow sufficient flexibility to replicate the actual operations); Snavely Rebuttal Comments at 8-9 (same). Even the American Chemistry Council et al. ("Joint Shippers"), which nominally argued against such adjustments (Joint Shippers Reply Comment at 25-32), concede that consideration of the added costs of STB-prescribed mileage payments for private tank cars would not be contentious. *Id.* at 29.

explosives.[4] They also would require carriers to ensure the "attended" transfer of all such cars moving to and from shippers, receivers, and other carriers at transfer points inside and even outside high-threat urban areas so long as the car will at some point in transit move through such an area.

Finally, additional costs are also expected from the regulations proposed (also on December 21, 2006) by the Pipeline and Hazardous Materials Safety Administration of DOT ("PHMSA").[5] Those regulations would require carriers to report volume and route specific data for cars containing the most hazardous hazmats or significant quantities of certain radioactive materials or explosives; conduct a safety and security risk analysis for each route used; identify a commercially practicable alternative route for each route used; and select for use the practical route posing the least safety and security risk. The costs associated with additional security, inspection, monitoring, tracing, reporting, and potential alternative routings for this traffic that will result from the security action items and the expected regulations will be significant.[6]

---

[4] *See Rail Transportation Security*, Docket No. TSA-2006-26514, 71 Fed. Reg. 76851 (proposed Dec. 21, 2006) (to be codified at 49 C.F.R. Parts 1520 & 1580).

[5] *See Hazardous Materials: Enhancing Rail Transportation Safety and Security for Hazardous Materials Shipments*, Docket No. RSPA-04-18730 (HM-232-E), 71 Fed. Reg. 76834 (proposed Dec. 21, 2006) (to be codified at 49 C.F.R. Parts 172 & 174).

[6] TSA estimates a 10-year cost to the private sector of $152.8-$173.9 million for establishing a secure chain of custody and underlying reporting requirements for the movements covered by its proposed regulations (71 Fed. Reg. at 76877); PHMSA estimates a $20 million, 20-year cost for collecting and retaining data and performing required route safety and security analysis (71 Fed. Reg. at 76845). Moreover, these estimates do not take into account the much larger indirect costs to the rail network from altered and less efficient operations that are likely to result from the regulations. *See, e.g.*, Comments of Norfolk Southern Corp in Docket Nos. TSA-2006-26514 and RSPA-04-18730, filed Feb. 20, 2007, at 8-12.

The case for allowing consideration of the substantial added costs associated with the transportation of hazmat materials is particularly compelling because the railroads cannot avoid these costs and there is a strong public interest in promoting the safe transportation and handling of these products. As recognized by PHMSA, hazmat materials are "essential to the economy of the United States and the well being of its people."[7]

> . . . . Hazardous materials fuel motor vehicles, purify drinking water, and heat and cool homes and offices. Hazardous materials are used for farming and medical applications, and in manufacturing, mining and other industrial processes. Railroads carry over 1.7 million shipments of hazardous materials annually, including millions of tons of explosive, poisonous, corrosive, flammable and radioactive materials.
>
> The need for hazardous materials to support essential services means transportation of highly hazardous materials is unavoidable.[8]

Railroads have an obligation to haul these products on reasonable terms. In doing so, they face significant risks of liability and a panoply of expensive regulatory requirements designed to protect the health and safety of producers, consumers, workers, and the general population. If the Board were to ignore these very real and unavoidable costs in determining rate levels, the effect would be to impose a penalty on carriers for fulfilling their important obligation to carry these goods safely and securely.

Thus, the Board should permit adjustments to system average URCS costs to take into account the added costs for shipments such as hazmat materials. Unlike Ex Parte No. 657 (Sub-No. 1), in which the Board determined (over the objections of the AAR and

---

[7] *Id.* at 76835.

[8] *Id.*

others) to disallow adjustments to URCS system average costs for purposes of its initial jurisdictional determination in full SAC cases,[9] the need for such adjustments is central to the Board's process of ratemaking under its proposed simplified procedures. Simplified SAC uses URCS to calculate operating and equipment expenses and the Three Benchmark methodology uses URCS to establish R/VC ratios that are used to determine reasonable rate levels. Whatever discretion the Board may believe it has to disallow adjustments to URCS system average costs in the context of a jurisdictional determination,[10] CN respectfully submits that it must consider critical costs as part of its central ratemaking function. As CN pointed out in its rebuttal comments, failing to do so could have the practical effect of prompting a flood of rate cases under its simplified standards (or threats of such cases) by shippers seeking to take advantage of the Board's prohibition on adjustments to URCS by challenging movements that have substantial costs that are not taken into account or are grossly underestimated by unadjusted URCS costing.[11]

CN understands that the Board initially proposed foregoing such adjustments out of concerns about the potential time and expense that such consideration might require. The shippers who object to consideration of the railroad's full costs have argued that such adjustments are incompatible with the Board's expedited schedules under its simplified rail rate standards. As discussed below, the Board can overcome these concerns and objections by defining and limiting the scope of adjustments to system average URCS, and by adopting procedures under the simplified SAC and Three Benchmark

---

[9] *Major Issues in Rail Rate Cases*, slip op. at 50-61 (served Oct. 30, 2006).

[10] *See* 49 U.S.C. § 10707(d)(1)(B).

[11] CN Rebuttal Comments at 4-5.

methodologies that readily accommodate limited adjustments without requiring additional time or significant added expense.

B. The Board can reasonably limit the adjustments it will permit to URCS system average costs.

It is well within the Board's discretion to draw principled distinctions between proposed adjustments and to determine to allow some adjustments and disallow others. Logical criteria for making such determinations include: (1) whether the cost is actually incurred by the carrier but not included or grossly understated by URCS (or, conversely, whether URCS includes a distinct cost that is not incurred by the carrier or URCS grossly overstates such a cost); (2) whether the actual cost can be estimated or ascertained with reasonable effort and certainty; and (3) whether the amount of the cost adjustment is likely to be significant as compared to the overall variable costs of the movement.

By using such criteria, the Board can make an initial determination based on the record in this proceeding that certain proposed adjustments should be permitted while others should not. Making such an initial determination would allow the Board to reduce significantly the time and expense of considering adjustments in individual rate proceedings. CN and the other major railroads have already identified the major types of adjustments they believe are appropriate. Those limited adjustments meet the above criteria and should be permitted in future rate cases. Chief among them are the special costs related to movements of hazmat commodities, which CN has discussed in its previous filings and again, in detail, above. In addition, CN and other carriers have discussed the propriety of adjustments for railroad payments to third parties providing portions of the transportation at issue and for movements of high/wide shipments. CN

urges the Board in its final rules to provide for URCS adjustments for special hazmat costs and for these other costs.

Shippers have also proposed or discussed a number of possible URCS adjustments that the Board may wish to consider in this proceeding, and those likewise should be considered (as should adjustments that may be proposed by parties in future individual rates cases) under criteria such as those suggested above.[12] As the Board resolves such additional requests for adjustments on a case-by-case basis, it would provide guidance that can be used to avoid repeated litigation over various adjustments.

[12] For example, Snavely King proposes as an appropriate adjustment the removal of some or all switching costs from system average URCS costs where a shipper performs or pays a third party for switching at its facility (presumably for no direct compensation from the carrier). Snavely King Reply Comments at 7; Snavely King Rebuttal Comments at 8. If the rail carrier paid for these services, then an adjustment to URCS to recognize that payment might be appropriate. Otherwise, this may not meet the criteria for an acceptable adjustment. First, if the carrier does not pay for the switching service provided by (or for) the shipper it is evidence that the service is not being performed in lieu of the carrier's service or for the carrier's convenience and benefit (thereby relieving the carrier of some significant expense), but rather for the convenience and benefit of the shipper. Second, the fact that a shipper may choose to perform or pay for certain third-party services with respect to its rail cars does not demonstrate that the carrier has not performed all of its usual services. In the case of switching, for example, the fact that a carrier may pay to have some cars switched into or within its facility does not mean that the carrier has not had to perform switching in spotting the shipper's car or moving it to or within its yard. A claimed adjustment of this type fails to meet the criteria for an acceptable adjustment because it would require in each case a laborious and expensive special operations or engineering study, and even then it would be difficult and contentious to quantify any cost difference, which for a movement of any length would likely be *de minimus*.

C. The Board's procedures under the simplified SAC and Three-Benchmark methodologies can readily accommodate limited adjustments to URCS system average costs.

At the January 31, 2007 hearing, CN suggested that the Board can consider adjustments to URCS system average costs within the framework of its proposed procedural schedules, and it promised to elaborate on this point in its supplemental comments. As discussed above in Part B, a proposed adjustment may have already been considered and accepted by the Board prior to a future rate case, whether in this proceeding or after being proposed and accepted in an earlier simplified rate case following this proceeding. In other instances, a party in a future rate case may wish to propose a new type of adjustment not previously considered by the Board. CN proposes that in all cases the party seeking an adjustment be required to carry the burden of persuasion that the adjustment meets the Board's criteria.

Whether or not a particular proposed adjustment has been accepted previously by the Board, and whether a rate challenge involves the simplified SAC or the Three Benchmark methodology, the process for considering a proposed adjustment in a future simplified rate case may be broken down into five steps which can be accommodated by the current proposed procedural schedules. These basic steps include:

> (1) A party proposes an adjustment, including a proposed basic means of estimating or determining the amount of the adjustment.
>
> (2) The Board tentatively accepts or rejects the proposed adjustment.
>
> - If the adjustment is of a type previously determined by the Board to be appropriate, tentative acceptance is automatic and the Board proceeds to Step 3. (Acceptance is "tentative" because the proponent would still have to show in the individual case that

the amount of the adjustment can be reasonably determined.)

- If the adjustment is not of a type previously determined by the Board to be appropriate, the party opponent may object to the adjustment and the Board will then make a tentative determination in accordance with established criteria (see Part B, above) to accept the adjustment (and move on to Step 3) or to reject the adjustment (in which case it would be disallowed).

(3) The scope of discovery in the case includes information for adjustments that have been tentatively accepted.

(4) The merits phase of the case includes final arguments as to the estimated amounts of tentatively accepted adjustments (including whether the adjustment should be rejected because it cannot be adequately estimated or determined).

(5) In its final decision the Board accepts or rejects proposed adjustments.

Implementation of these basic steps in the procedural schedules of simplified SAC and Three Benchmark cases would be straightforward, and would not require additional time. The first two steps above could take place during Phase One of these cases (during which eligibility for the rate methodology is considered).[13] The remaining steps three through five could then be accommodated in the normal corresponding phases of the procedural schedule. Discovery, argument on the merits, and the Board's final decision would simply include the issues related to consideration of any tentatively accepted URCS adjustments.

[13] Alternatively, or in addition, if the Board decides to impose mandatory mediation for simplified rate cases, steps one and two could begin during the mediation phase of the case.

Consideration of URCS adjustments in these established time frames should be practical and any added costs should be reasonable. As the Joint Shippers economic consultant, Thomas D. Crowley, indicated at the Board's January 31, 2007 hearing, foregoing such adjustments saves relatively little time and expense. Moreover, procedures such as those outlined in these comments would help to minimize the required time and expense for consideration of proposed adjustment to URCS system average costs. The criteria for adjustments suggested by CN would provide guidance to parties as to likely acceptable adjustments, and would limit those adjustments to those that are significant, distinct and actually incurred, and capable of being estimated or determined with reasonable effort and certainty. Further, the Board's ability to determine in this proceeding and in future cases which adjustments would and would not be permitted should avoid the need to re-litigate similar issues repeatedly. Finally, by squarely placing the burden on the proponent of an adjustment to demonstrate that it is appropriate, parties would be unlikely to advance weak and frivolous claims.

In the end, whatever modest additional time and expense might be required to consider the relatively narrow range of URCS adjustments that would be appropriate for rate cases brought under simplified standards would be far outweighed by the importance of those adjustments to the integrity of the Board's standards.

Respectfully submitted,

Paul A. Cunningham
David A. Hirsh
HARKINS CUNNINGHAM LLP
1700 K Street, N.W., Suite 400
Washington, DC 20006-3804
(202) 973-7600

Sean Finn
Senior Vice-President Public Affairs,
Chief Legal Officer and Corporate Secretary
CANADIAN NATIONAL RAILWAY
COMPANY
P.O. Box 8100
Montréal, PQ H3B 2M9
(514) 399-6500

Theodore K. Kalick
CANADIAN NATIONAL RAILWAY
COMPANY
Suite 500, North Building
601 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 347-7840

February 26, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this 26th day of February, 2007, served the foregoing Supplemental Comments of Canadian National Railway Company on all parties of record in this proceeding by first-class mail or a more expeditious method of delivery.

Jared H. Powell